Commonwealth Bank of Australia

Transcript – 2020 Full Year Results Briefing

For the full year ended 30 June 2020

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Introduction

Melanie KIRK: Hello and welcome to the Commonwealth Bank of Australia's Results Briefing for the year ended 30 June 2020. I am Melanie Kirk and I am Head of Investor Relations.

Thank you for joining us. For this briefing we will have a presentation from our CEO Matt Comyn with an update on the business and an overview of the results. Our CFO, Alan Docherty, will provide details of the financials, and Matt will provide an outlook and summary. The presentations will be followed by the opportunity for analysts and investors to ask questions. I will now hand over to Matt. Thank you Matt.

Presentation from Matt Comyn

Matt COMYN: Thanks very much, Mel, and good morning everybody. Before I start I just wanted to acknowledge what a challenging six months it has been for Australians right around the country, starting the year with bushfires, but of course more recently the coronavirus pandemic.I particularly want to pass on our best wishes to our customers, to our people, and of course the broader community in Victoria.

During that period we have been doing our best to make sure that we are working hard to support our customers and making sure that we are continuing to consistently execute our strategy and deliver balanced outcomes across a range of different settings. We feel that we have made very good progress during that period, and I am just going to step through some of those highlights now.

We have responded very quickly as we have needed to and put substantial support in place for our customers. We have responded to almost a million different requests for assistance over the last few months. That has enabled us to put in place substantial support particularly around repayment deferrals, where we have deferred almost 250,000 repayments. We have also made 250 million personalised support messages through our CommBank app. We have also made sure that during that period of time we have continued to support our customers with $100 billion of home lending, and $27 billion of new business lending over that time.

Pleasingly we have seen big increases in our employee engagement, up 13 percentage points to 81%. And I also want to just thank all of the Commonwealth Bank staff for their amazing support and hard work during that period to support our customers. That has enabled us to perform well across a range of different settings and for our shareholders. Our final full year dividend of $0.98 in the second half represents 49.95% of statutory profit, which is reflective of APRA's expectations.

As part of supporting our customers we have been able to leverage the technology and digital investments we have been making for many years. In particular we have seen more than 5.5 million visits to our CommBank app and Netbank, particularly to our information pages where we have made sure we have had up to date Federal and State guidance, and some practical information for our customers.

In responding to supporting our business or SME customers, we have leveraged existing investments in our BizExpress technology and decisioning, to process just over 50% of the SME loan guarantee schemes, helping our customers ensure that they could make their payments to their employees and participate in the JobKeeper scheme.

Pleasingly we have seen those investments and technology like BizExpress where now, for eligible customers, we can move from an application, decisioning, online acceptance and funding directly into the customer's transaction account, in under 20 minutes. And as part of looking to provide real value to our retail customers via our CommBank app, we have continued to extend our Benefits Finder capability where we have seen a 78% increase in the last six months in terms of benefits. That has meant that more than $150 million has been delivered to our customers since we launched the Benefits Finder functionality.

Now just touching very briefly on the result. Our statutory profit was up 12%, it is the basis on which the dividend calculation was made, and the majority of that improvement or increase year-on-year is as a result of the divestments, predominantly the asset management divestment. Our cash net profit after tax was down 11%, and our Common Equity Tier 1 finished at 11.6%, which is approximately a $5 billion surplus above APRA's unquestionably strong 10.5%.

Our full year dividend for the year of $2.98 is fully franked, and again consistent with APRA's expectations.

Over the full year our cash NPAT, we saw our income up 0.8% from strong volume growth, which I will unpack a little on subsequent slides. Our operating expenses up 0.7% for the full year, or 0.4% sequentially. We saw our loan impairment expense up 33 basis points, which is predominantly driven by that $1.5 billion forward looking adjustment that we took in our third quarter. And as I said our cash profit down 11% for the year.

We have seen that core franchise strength really come through clearly over the course of this financial year. In particular we continue to focus very closely on our customers, and watch the results of that through our Net Promoter Scores which pleasingly we have seen some improvements throughout the course of the year, right across all of our businesses, and again in our digital banking solution we finished with our highest ever Net Promoter Score which is of course critical to our long term strategy.

Our operational execution I think can be highlighted in a couple of particular areas. Obviously areas like BizExpress which I have touched on, but also just the commitment and dedication to making sure we have kept very consistent home loan decisioning times during the course of the year has enabled us to again deliver a very strong home lending result of 1.3 times system. That business lending result of $7 billion, up 5.1% for the year, and we actually saw the strongest growth in that fourth quarter that we have seen for the last couple of years.

In particular one of the standout performances right across the business has been our deposit growth, and in particular our transaction deposit growth, where we have seen a $25 billion and 25% increase in household deposits.

Just spending a moment on deposit growth more broadly. We have seen total deposit growth over the course of the year of $64 billion, that is the most growth that we have ever seen by dollar value. And when we break that down again into particularly valuable deposits of transaction balances, we have seen $45 billion of growth over the year, and $30 billion of that coming in the second half, which has really been a phenomenal result right across all of our business units.

As we look at our balance sheet, we have continued to strengthen what we were already very well positioned and we feel like we have got overall now the strongest balance sheet we have ever had. A couple of ways that is reflected in particular is through that deposit funding which I mentioned. We saw a five percentage point increase during the course of the year, up to 74% deposit funded. And as you can see, set aside the GFC, there is an increase of almost 20 percentage points during that period.

The forward looking adjustment that we took in the third quarter sees us with total provision coverage of $6.4 billion, or 1.7% as a function of credit risk weighted assets, which is still peer leading. And again that Common Equity Tier 1 of 11.6% is a very strong outcome, and we also see another between 58 and 68 basis points of capital to be generated inorganically from previously announced divestments which have not yet completed.

The next few slides we have really tried to break down and provide some additional disclosure around repayment deferrals, given the understandable interest in this area. We have developed some technology to make it easier both to analyse and understand what is going on, but of course to ensure that it is an efficient process for customers opting into the repayment deferral process, as well as opting out. And you will see the disclosure here that we have provided. We have seen quite a reduction in customers coming out of their repayment deferrals, even though in the context of home lending and business lending they were entitled to the full six month repayment deferral. Pleasingly from a personal loan perspective almost 95% of customers have recommenced their repayments.

We have also made that opt out process an easy one from a customer perspective on Netbank and the CommBank app, and we have also made it easier for customers to look at interest only as an option. I think unlike other cycles where the cash rate is now, it means that interest only is a very viable option for many customers, a typical loan size is approximately $350,000.00, so a repayment amount of interest only is approximately $200.00 per week.

Now trying to split out some of the analysis in more granular detail on the next couple of slides.

First starting with home lending, and this is a predominantly analytical exercise that we are augmenting obviously as we are in regular contact with our customers. And what we have provided here is a breakdown using one of our home loan risk scoring models. It typically includes a number of the factors that you would ordinarily expect; so things like dynamic LVR, how far a customer is in advance on their repayment history, the industry sector that they work within, things like interest only versus principal and interest, owner-occupier versus investor. We have also added in variables such as JobSeeker. You will see that disclosure there on the slide of 13.6% of our accounts tagged to a JobSeeker payment, although 58% or 7.6% where there are joint accounts with one party are receiving JobSeeker payments. This has of course been possible because in about 90% of cases we have an active transaction account associated with our home loan, so we feel like we have got an accurate read on what is happening in the customer's account, and of course changes to income are an important variable within that overall model.

You will see on the left hand side some disclosure there in terms of active accounts that are in deferral as at July. We have seen a continuing reduction throughout August, but a slight increase, obviously as you would expect, through Victoria, but at least month to date in August we expect that that number is going to be flat or slightly down. We have provided the dynamic LVR of less than 80%, 67% of the book, and that is an important variable. And of course as I said 14%, 12 months or more in advance.

Similarly from a business lending perspective we have looked at a number of different variables including the occupation sector, changes in and around cash flow, their behavioural repayment history, and you see an active breakdown on this slide both between our States, where the geographical distribution is by sectors. I think importantly if you look at the home loan slide there was 25% of our customers were making some form of repayment. In business lending that skews even more to actually be 30% of customers that are on a repayment deferral at the moment are making their repayments in full.

89% of our customers are secured, so one way to think about it is 67% fully secured, and say 22% are partially secured, leaving 11% of unsecured, and just over 50% are relationship managed. Obviously relationship managers play a very important role in terms of maintaining regular contact with customers, but also bring a depth of understanding about business plans, inventory, supply chains in our broader overall assessment as we go through the reviews with our customers.

As I said at the start, we have made good progress in consistently executing our strategy during the course of the year. We announced the divestment of 55% of our CFS business to KKR earlier this year, which we expect to complete in the second half of this financial year. We also announced as part of our results, the latest report from the independent expert Promontory, we are making good progress, having completed almost 80% of our milestones.

You will see overall very strong share performance above system growth clearly in deposits, in home lending, stronger performance in business lending, and again that improvement that we are seeing, not just in our Net Promoter Scores but also more broadly in the context of the reputation and standing of the business going forward. Of course those investments in digital banking and our technology more broadly, absolutely critical to our future strategy.

We really want to position ourselves as the trusted and relevant partner at the centre of our customer's financial lives. An essential part of that is being the number one digital Bank. We have been recognised in that way for the last four years by Forrester and 11 years by Canstar, and we have continued to invest in some leading features and functionality to improve the quality of the experience for our customers.

Just a couple of recent examples. First of all we rolled out, in the last month or so, a Coronavirus Money Plan which just provides some simple but actionable insights and steps for our customers to be thinking about. We have seen more than 300,000 customers use that already.

Our bill prediction tool, which actually helps, of course, customers manage and expect what bills are coming through. We have seen almost a million customers start using that in just the last three weeks. Perhaps just to give an insight about how some of the unique elements about technology come together. In building something like the bill prediction tool, we are using 14 billion transactions. We then calculate 150 million different bill presentment options. We are using 20 machine learning models, and we deliver that into a personalised experience which of course continues to improve the experience, and is personalised to our individual customers.

We have made some very good progress in and around our Payments Innovation, that is a huge priority for us going forward, continuing to work very closely with Klarna. We had a technology and innovation update a couple of weeks ago. We will continue and we look forward to bringing some more exciting innovations to market in the months ahead.

At this point I am going to hand over to Alan who is going to talk about the result in more detail.

Presentation from Alan Docherty

Alan DOCHERTY: Thank you Matt, and good morning. Financial year 2020 has certainly been one of our more interesting periods, and I will step through it in more detail shortly. In summary terms, what really stands out for me is that despite a difficult environment in both social health terms and economic terms, the structural advantages of our franchise coupled with our disciplined execution of a strategic and operational priorities has delivered a pretty good set of outcomes for our customers and our shareholders.

Before the coronavirus pandemic we were already experiencing the earnings pressure of a lower for longer interest rate environment. While that represents a headwind in absolute terms, in relative terms the Commonwealth Bank performs better in a falling rate environment. Our structurally advantaged franchise product mix and our balance sheet settings help us deliver less volatile earnings through the cycle, and generate structurally higher levels of organic capital.

After the onset of coronavirus and the associated economic downturn, customer behaviours changed in two ways, which also play to our franchise strengths. A scale advantage that attracts more customers to the Commonwealth Bank during uncertain times, and an acceleration in the level of our customers' digital engagement. We have built upon those strengths with strong operational execution in the Retail Bank and better capital disciplines across the Group. We have strengthened all of our balance sheet settings, and then extended that balance sheet in support of our retail, business and institutional customers across both Australia and New Zealand. That has resulted in strong growth in home loan market share, a large capital surplus both before and after the dividend, strengthened levels of loan loss provisioning at 30 June, and an exceptional period of customer deposit growth.

Now onto the detail. Let me start off as usual with the reconciliation of total statutory profits to cash profits from continuing operations. Statutory profits for the year were $9.6 billion, largely due to one-off gains on the sale of our various Wealth Management businesses. All the usual adjustments apply, with Colonial First State now the main contributor to profits from discontinued operations. Those adjustments result in cash profits from continuing operations of $7.3 billion. As Matt has described, that cash profit is 11% lower than last year. Operating income, operating expenses, and operating performance are all up by around 1%. It was the loan impairment expense more than doubling to $2.5 billion which drove that reduction in cash profits.

Looking firstly at operating income, the growth was driven by higher net interest income more than offsetting the impact of COVID-19 on other banking income, and lower fees in our funds management and insurance businesses. That growth in net interest income of $386 million was a function of strong volume growth across our core products, with average home loan balances up 4%, another strong period of double digit transaction deposit growth, and positive momentum in business lending.

Institutional lending balances were 5% lower on average year on year, however spot lending exposures increased slightly as the business continued to support key clients' liquidity needs during a difficult period. As you would expect net interest margins were lower over the year, and if you look at the sequential change over this half, margins fell by seven basis points, asset pricing provided a small benefit of two basis points. The margin pressure from a lower rate environment can be seen in the five basis point reduction in deposit funding and pricing, and a three basis point impact of lower earnings on invested capital.

The other phenomenon that we are seeing right now is a very high level of excess liquidity, principally due to that strong growth in transaction and savings deposits. Those excess liquids are deployed in very low rate, high quality liquid assets, diluting our headline margins by four basis points. As we look ahead we expect the cash rate reductions will result in a seven basis point margin headwind over the next financial year. It is also likely that we will continue to carry excess liquids during a period of economic uncertainty, and so it is likely that that will dilute headline margins, although that is a little harder to estimate at this point.

Operating expenses grew by 0.7% over the year. That was helped by a reduction in customer remediation costs of $381 million, despite the increase in aligned advice provisioning that we took in the second half of the year. If we exclude notable items, underlying costs grew 2.7%. Within that we absorbed higher staff, property and IT costs, partly due to the impacts of coronavirus. We scaled up the operational resourcing of our Customer Financial Assistance and Collections Teams. We understandably have seen lower levels of annual leave taken. We made all our branches and commercial offices COVID-safe for our people and our customers, and we invested in IT infrastructure to enable 39,000 of our people to work from home.

While this is the second successive year of cost growth since we announced our strategic priority of business simplification and cost reduction, it is pleasing to see growing momentum and productivity benefits. We have delivered $548 million of cumulative cost savings this year, an increase of $358 million on the prior year, and this will continue to be an important area of management focus given the weaker earnings outlook.

Turning to our balance sheet settings and looking firstly at credit risk. Loan loss rates increased significantly across both consumer and corporate portfolios due to forward looking adjustments to provisions for the impact of COVID-19. We can already see some signs of emerging stress across the portfolio, although it is early days. Within the consumer portfolio both home loan and personal loan 90 day arrears remain below the levels that we have seen last year, however both of these products have been insulated by the loan deferral arrangements that have been in place since March.

Credit card 90 day arrears increased 43 basis points to 1.23%, although around half of that increase relates to the denominator effect of lower credit card balances. Troublesome and impaired assets increased $900 million to $8.7 billion, with most of that increase related to higher corporate troublesome exposures from a relatively small number of institutional clients in those sectors most exposed to the coronavirus lockdowns including retail trade, manufacturing, transport and culture and recreation.

We have been focused on supporting our Retail and Business customers during a difficult period. The loan deferrals along with the very strong fiscal, prudential and monetary policy response are providing individuals and businesses with much needed time to mount a recovery. However, we know that unfortunately not all of our customers will be able to fully recover, and we have therefore been conducting very granular modelling of the expected impacts across both our Retail and non-Retail portfolios.

For our Retail lending portfolios, we have conducted analysis of our customer base across a number of dimensions including their occupation, where they live, their payment activity and for home lending, their level of equity. For our non-Retail lending portfolios, we have looked at the expected change in cash flows for those businesses operating within impacted industries and geographies, and that has informed the degree of notching that we have applied to the probability of default and loss given default for those exposures, as part of our forward looking adjustments.

And that approach has enabled us to continue to take a careful approach to our provisioning. And as a result we have increased our collective provisions in the consumer portfolio by 32% and in the corporate portfolio by 48%. That takes our total provisions as a proportion of credit risk weighted assets to 1.7%, the highest in the industry, along with the most highly collateralised lending portfolio.

As we look ahead at the alternate economic scenarios, we are well positioned for whatever the future may hold. Our current level of provisioning is $1.1 billion higher than the level of provisions that we calculate would be required under our base case economic forecasts. That extra level of provisioning provides our earnings and capital levels with a degree of insulation should we experience a more severe, prolonged downturn scenario.

We continue to strengthen our funding settings. Our customer deposit ratio is now 74%, and the weighted average maturity of our long term debt is now 5.3 years. We continue to reduce funding risk in other ways, for example a reliance on short term funding sources is now at historical lows.

We also have access to $31 billion of three year funding from the RBA’s term funding facility, and that provides us with another stable source of funding as we seek to support our customers and the economy during the difficult period ahead.

On capital, we have delivered a Level 2 Common Equity Tier One capital ratio of 11.6%, down 10 basis points since December 2019. That represents a significant surplus to APRA’s unquestionably strong capital requirement, and will be further strengthened by the expected capital uplifts as we finalise our announced divestments.

During the six month period we absorbed the $1.5 billion increase in COVID-19 loan loss provisioning, and $3.5 billion in cash paid in neutralised interim dividends. That was offset by another strong period of underlying organic capital generation and 26 basis points of inorganic capital from completed divestments.

Importantly our Level 1 parent entity capital remains significantly higher than our Level 2 Group capital, which means we are uniquely well placed to absorb RBNZ’s freeze on dividend payments from New Zealand banking subsidiaries.

Looking at the trajectory in our capital levels over the course of the past year, you can see that we remained above unquestionably strong capital levels for all 12 months, including the months following the declaration and payment of our last two dividends. As you would expect, there has been a degree of volatility in our capital levels over the course of the past year, in particular over the last two quarters. In Q3 we have seen weaker profits from the COVID-19 provisions and the timing of the interim dividend.

We have also seen higher credit spreads and market volatility in the month of March and that resulted in a 95 basis point fall in Q3 CET1. In Q4, we have seen stronger profits and a tightening of credit spreads. We also adopted a more granular calculation of credit risk weighted assets on defaulted exposures providing a nine basis point improvement to CET1. These benefits offset the deterioration in credit quality and delivered an 85 basis point increase in Q4 CET1.

The final dividend of $0.98 reflects APRA's recently updated guidance and sees us retain more than half of our second half statutory earnings. That represents a cautious approach to capital management and dividends as we head into a period of economic uncertainty. I want to hand back to Matt for the outlook and the closing summary. Thank you.

Outlook and Closing Summary from Matt Comyn

Matt COMYN: Thanks very much, Alan. Just turning to the economic outlook, and clearly there is considerable economic uncertainty in the periods ahead. As we have thought about it, we have obviously tried to prepare for a range of different economic scenarios. The way we see Australia and New Zealand certainly on a global basis, to be extremely well positioned at both a health outcome perspective as well as economic, notwithstanding the setbacks in both Victoria and New Zealand in the last 24 hours.

We entered this period in a period of significant fiscal and economic strength. We have a strong tailwind from mining exports. It has been a clear recovery in the agricultural sector. There is a very strong pipeline of infrastructure projects in place at both a federal and state level, and of course we have seen very closely and worked constructively with all arms of government and with our regulators to make sure there is substantial support in place, from not just the financial system, but of course very effective income support from the Federal Government.

As we look forward, we have based our central scenario on the Reserve Bank forecast which came out in May. We have reviewed their more recent forecasts. They are very closely aligned. We have got unemployment at 9%, I think they have got it at 10% at the end of the calendar year. I think that is really going to depend on the participation rate. Clearly there is some degree of understatement in both of those numbers just given the impacts on the broader economy.

We have got the economy contracting at about 4% this year before recovering by 2% next year. But we feel that the organisation is very well positioned to navigate through a range of those different scenarios and clearly there will be a lot of uncertainty and a number of different factors that are going to drive the economy in the near term, in terms of the ongoing suppression of the virus. A clear impact on business and consumer confidence, which we have seen contract, and more broadly as we see a tapering, appropriately of some of that income support, there is going to be a lot of stimulus required to generate aggregate demand and future employment to try to bring that unemployment rate down from close to 10% over the next couple of years.

And notwithstanding, of course, more broadly we will be dependent on what sort of progress is made in and around vaccines, various treatment, how effectively at individual, community and state level the virus can be supressed. And, of course, as I said the flow through of impact onto business and consumer confidence.

In summary, as I said at the outset, we have worked very hard and quickly to try and put substantial support in place for our customers and for our communities.

We have seen strong improvements across a range of different metrics from our Net Promotor Scores to our reputation more broadly, also right through into our employee engagement.

We have consistently focused on executing our strategy and continuing to execute our core business performance very well. We have seen a very strong performance in a number of our markets like deposits, above system home lending growth. We feel that the balance sheet is in very strong condition. Big improvements in our deposit funding. We feel very well capitalised with a pipeline of inorganic capital still to come, which ultimately, I think, positions the Commonwealth Bank very well for a range of different economic scenarios. And on that point, we will hand over to Mel for Q&A and Alan and I will be happy to take your questions.

Q&A

Melanie KIRK: Thank you Matt. For this briefing we will be taking questions from analysts and investors, we will be taking them from the phone lines. I will announce your name, and then wait for the phone line to open. Please limit your questions to no more than two questions. We will start the questions with a question from Richard Wiles at Morgan Stanley. Thank you Richard.

Richard WILES: Good morning everyone, can you hear me?

Matt COMYN: Morning Richard.

Richard WILES: Good morning. So I have a question on troublesome exposures. Slide 105 includes troublesome exposures by industry. Can you explain why the ratio fell in accommodation, cafes and restaurants? That hardly seems credible given what's happened over the past few months. And could you also explain why troublesome exposures are down in the property industry and also in the construction industry?

And then I have a second question on expenses, which I'll proceed to in a moment.

Alan DOCHERTY: I mean, as I mentioned in the presentation, Richard, what we have really seen in troublesome exposures this year is really movements in Institutional client exposures as you tend to see in the early part of a stress. Now I called out some of the areas where we had seen a significant net increase in corporate troublesome exposures, and particularly impacted industries. Obviously some of those industries are more overweight Institutional clients relative to some of the other industries, including accommodation, cafes and restaurants, which is more heavily weighted towards the Business Bank.

So you are going to see a little bit of noise in TIAs in the early part of this stress in one direction, because you are going to see the emergence of stress within single Institutional clients more quickly, and then as you roll through later periods of the stress, that will emerge in individual businesses.

So you have seen a little bit of noise in the movement of the TIAs based on single exposures moving in and out of troublesome, and also the weighting between Institutional and Business exposures across these various categories.

Matt COMYN: Yes Richard, the only thing I would add to that is really the process that we have been going through over the last few months is going through at an individual, and risk-based across each of those different categories in completing in depth reviews. So if you think about it, in the Institutional Bank where clearly there are a smaller number of exposures, they would be close to 100% of the way through their client base, and across the Business Bank it would be in the order of between 70 and 80% depending on the sector.

So you mentioned accommodation, cafes, restaurants. We have been through 80% of the values by exposure, actually 50% of them have had some form of downgrade. I think commercial property you mentioned, I think we have reviewed

100% of the exposures in the Institutional Bank, 90% of the exposures in the Business Bank. So I think to Alan's point, there is just some noise in terms of the movements in and out. But we do feel like there has been very thorough coverage and reviews, and particularly it is easier obviously to see the impact and movements around probability of default in particular, and so there has been some considerable downgrades, and of course some of the notching that goes into the calculation of the forward looking adjustment.

Richard WILES: Okay, thank you. And just a question on expenses if I could. Alan, you acknowledged that in the last couple of years your costs have gone up, despite saying at the first half 2019 result 18 months ago that you were aiming for absolute cost reduction. Do you think you can achieve absolute cost reduction in full year 2021? The cost savings are going up, but that's not leading to a reduction in the cost base. So I'm just wondering how serious you are about reducing the absolute cost base in an environment where you've acknowledged the revenue pressure is increasing?

Matt COMYN: Yes, look Richard, maybe I will start and then throw to Alan. Certainly we are serious about it. As you said at that point in February 2019, we said two things. Absolute cost reduction. We also talked about a 40% cost to income ratio. I think we have had five cash rate reductions since then, which has obviously made the latter more challenging.

We recognise, or we believe we are making progress, and as you mentioned in terms of the benefits in each period. There is clearly more work still to do. I mean, full year at 0.7%, sequentially 0.4%. I think if not for the increase in the COVID related costs, which again is not an excuse, it is just an explanation, we would have got close to zero cost growth in that period.

I think on the other side I think we have been clear from the beginning we want to make sure that we deliver that performance, but we do not want to sacrifice the franchise or broader, more value creating options. I mean, in that context we have added about 5-700 people into our Financial Assistance Solutions Team.

We have clearly increased a number of operational roles. But you are quite right, as we have thought about the business plan this year, without giving any specific guidance, we recognise it is going to be a challenging income environment, and therefore our improvement in our simplification and cost reduction needs to step up.

Melanie KIRK: Great. We will take the next question from John Mott at UBS. Thank you John.

John MOTT: Yes, thanks Mel. A question, this relates more to slides 14 and 15, I'm going through these, which is more the deferrals. You gave us some good information on the distribution by risk score. But it's on the number of deferred accounts on the Y axis. If you reproduce that on the dollar value, because obviously you're going to have a large number of very low outstanding balance, which is going to skew this to the more positive side, is it possible to reproduce it or give us even the scores beneath the table based on the dollar value outstanding, rather than the deferred? So that's probably a comment or request.

And then also similar to that, can you give us in the profile the number of customers on JobSeeker? Have you also got the number of people on JobKeeper who may potentially be unemployed at some stage, given that those are going to come through?

Matt COMYN: Yes, sure John. So on 14, for home lending, we did, it's in 'accounts', and the distribution does not change very much for balances. There is more of a skew, which is why we have shifted on business lending to balances, because there is a high number of smaller exposures. There is not a big distribution in the context of the loan size on home lending.

To your second question around JobKeeper, yes, absolutely. We looked at it both in the context of personal as well as business. You will see on slide 15 we mention approximately 30% receiving JobKeeper at a business level. That is easier for us to recognise, because we can see the depositor details. When we look through our personal accounts, because of the nature of the way the JobKeeper is distributed, it actually goes to the employer, which then distributes it to the employee. We tried to band an algorithm, so we were basically looking for multiples of $1,500.00, but employers also top them up.

So we steered away from providing that disclosure because we felt, well, we know that we are understating it. So we do not have a sufficiently robust estimate to include on the slide, but in the context of the overall modelling it was certainly one of the things that we were looking to do, and if we felt that we could do it accurately, we would provide it.

John MOTT: And just a follow up question from that. Do you have a feel for the percentage of the deferred loans which are going to need further extension or movement to interest only at the end of the six months to qualify for the additional four months?

Matt COMYN: Yes, look, there are a couple of different data points. I mean, certainly in the way that we have approached, as we have here, as an analytical exercise which was then augmented through practical experience with our customers, we certainly believe the majority are in a position to exit their repayment deferral. That is also consistent in terms of where we have asked customers, and asked them for their intentions. Obviously we recognise that intentions can change over time.

And so then we are working through operationally over the next two months. We are going to contact obviously the entire customer base, we are going to leverage a number of different channels. But we have got approximately 250,000 calls to make or receive, because there are multiple contacts, we are using email, our app, asynchronous chat as part of that as well. So we have got a number of different options that of course we are going to try and tailor to individual circumstances.

So we have a hypothesis, but clearly that is also going to be impacted in terms of events even in the next couple of months, and how effectively the virus is suppressed in other states, and I dare say how quickly Victoria recovers.

John MOTT: Thank you.

Melanie KIRK: Great, thank you John. We will take the next call from Victor German at Macquarie.

Victor GERMAN: Thank you Mel. Two questions from me if possible, one on deposit margins and one on payments. So on deposits, I think both Alan and Matt, you talked about really strong growth that you have seen that you've seen in transaction accounts, which has been happening for around a couple of halves. Just when I look at your slide 23, it's not obvious on that waterfall chart where the benefit of that shift towards cheaper transaction deposits is coming from. If you maybe perhaps can talk to us, whether it is sitting in the deposit and pricing funding part of the bucket, or where else it is sitting, and the quantum that that is providing, versus the impact of the lower rates on your transaction and savings accounts.

Alan DOCHERTY: Sure, Victor. So you will see that benefit in the portfolio mix bar. So that portfolio mix really has the sort of substitution effect, if you like, of lower yielding customer deposits relative to other forms of funding. Now in the period, there are a couple of things going on in that portfolio mix bar as well as the change in the average funding ratios. So one, you need to look at the average change in the deposit ratio. So in the second half of the financial year where our spot deposit ratio was 74%. Obviously we have seen a lot of growth in the final quarter. So the average funding ratio is about 71.5% in 2H20. That plays about 70.5% in the prior half, so you have got that delta driving about two basis points of benefit in the sequential half.

Going the other way, you will have seen we had a reduction in consumer finance balances which are obviously very high margin relative to other forms of lending, so you have got a negative portfolio mix effect of one basis point there, and so that is why you come back to the one point of portfolio mix for the sequential half. But, yes, within that you can see that the margin benefit from that very strong growth in at-call transactions and savings accounts.

Victor GERMAN: Thank you, Alan. Would it be fair for me to assume that when you disclose a transaction saving accumulating impacts of eight basis points in the half, is that pretty much all impact of lower rates on those transaction and savings accounts before you get the benefit of replicating portfolio, is that the right way to look at it?

Alan DOCHERTY: Yes, so we have split that out in the call-out box so you can see the eight points across transaction and savings, and then there is an offset of two basis points from the replicating portfolio.

Victor GERMAN: Okay, thank you. Then second question, just on provisioning, I sort of feel like there's a little bit of a kind of disconnect in the way banks are thinking about this versus investors. I mean if I look at your chart on slide 27 where you look at your central downturn scenario, this is recognised impairments, it kind of almost implies that if your central downturn scenario plays out, you will have the write backs in 2021. I'm guessing that that's not the message that you are sending, and there's obviously lots of moving parts, but I'm assuming that as we go through 2021, you will have actual write-offs, and also the level of provisioning is likely to increase as the credit quality deteriorates. Can you maybe just talk to us about some of the moving parts as we move throughout 2021 within your central downturn scenario, how the write-off and provisioning is likely to play out?

Alan DOCHERTY: We are going to continue to evolve the central scenarios, the other scenarios, the severe downturn scenario. I mean we have seen, for example, the updated RBA baseline forecasts on Friday in the statement of monetary policy, and so we had another look at that central scenario against those metrics. It did not materially change that $5.3 billion central estimate. So we still feel comfortable with the additional level of provisioning that we are carrying.

Look I think we have had a track record over many years, Victor, of holding what we would consider to be very, we have been very careful around our provisioning. I mean you have seen that when we transitioned to the new account standard a couple of years ago. We took a top up in provisions at that point. I think at that time we would have been provisioned to 100% of our downside scenario. That was before, obviously, the events of the past six months. We have obviously adjusted all of those scenarios to the right and, again, we are comfortable that our level of provisioning is appropriate in the context of the uncertainty that we have got.

Yes, you will see as we start to see signs of the stress emerge across in particular the Retail and Business sectors, you will see increases in the level of write-offs. We will continue to revisit the level of collective provisioning that we hold as we start to see that transfer from collective to individually assessed provisions. We feel comfortable where we are today. We are going to continue to monitor the evolving situation, and I think, based on our track record, it is safe to assume that we are going to carry conservative levels of loan impairment provisions.

Melanie KIRK: Thank you, Victor. We will take the next question from Brian Johnson at Jefferies.

Brian JOHNSON: Thank you very much for the disclosures. A few questions. Just on slide 38, the new binding constraint on dividends at least for this year isn't cash earnings, it's basically statutory earnings. I was just wondering, could you give us a feeling on the P&L gains and losses on the sale of Colonial First State, CommInsure Life and BoComm Life when they come through? And then I have a second question if I may?

Alan DOCHERTY: You want a forward view of the…

Matt COMYN: Statutory profit. Yes, I mean, BJ, we have disclosed, obviously, the capital, but you are wanting to know what the forecast would be on realised gains through those divestments to the effect it is going to impact statutory profit in case that is the binding constraint for FY21 for dividends.

Brian JOHNSON: Correct. Because Matt when you think about it, this result was this result, but what helped your ability to pay the dividend was the net statutory gains down below the line. So we really, when we are thinking about dividends we have got to think about statutory profits, not capital, not basically cash earnings, it really does come down to the distortion from these statutory items. I was just wondering if we could get that.

Alan DOCHERTY: I think that is a really fair observation, Brian. I mean as we obviously put ASX announcements upon completion of major announced divestments. I think in the past we have historically focused, given the binding constraint historically has been capital levels on the CET1 accretion related to those divestments, but I think you make a very good point, and to the extent that we were not already going to do that, we will ensure that the non-cash statutory P&L is included as we complete.

Now obviously we cannot pre-announce those statutory profit impacts until we reach completion, because there are all sorts of completion account adjustments and considerations that go into that calculation. But to ensure that the market is well informed about our non-cash gains, we will ensure that as we complete, we will provide those details to the market.

Brian JOHNSON: Well then, as a subset of that question, may I ask then, does that imply that absent more gains going forward, the dividend capacity would actually go down in the next half?

Matt COMYN: BJ, I mean, there are a couple of difficulties with that question. One, the APRA guidance, it has been made clear, applies for this calendar year. Now, of course, there may well be new guidance in 2021 which would apply then to our interim dividend. So I think it is going to depend a little bit on, there are a number of factors, notwithstanding the overall economic outlook, and whether APRA feels that it is necessary to provide ongoing guidance, and then the consistency of that guidance the second time around. But we will certainly take it away. I mean I could not give you the forward looking estimates on the spot, but I understand given the calculations and the way the market will be thinking about it. We will certainly think about how to best disclose that.

Alan DOCHERTY: And it is worth just bearing in mind Brian, on the second half cash earnings, obviously that second half, we absorbed both the $1.5 billion top up in the COVID-19 loan loss provisions, and we have also seen the $400 million of other notable items on customer remediation programs, and most notably that aligned advice provisioning that we took in the second half. So the second half cash earnings did have some significant items in them as well.

Brian JOHNSON: The second one if I may. Just on slide 23 where you're talking about the cash rate creates this seven basis point NIM headwind in FY21, if you think about where we are, we have got a cash rate of 25 basis points that the RBA has said is the effective lower bound. We've got so much liquidity slopping around the system that we've probably got a 10 to 12 basis point 90 day bank bill rate. So very good basis risk, but that's probably less important. We have got a three year rate of 25 basis points, but then when you have a look at the five and the 10 year, the 10 year bonds haven't really moved a zat since February. Can we just get a feel on what would happen to this interest rate sensitivity if the RBA was to cut the cash rate to 10 basis points? And then alternatively, if the RBA was to start buying five and 10 year bonds to flatten the long end of the yield, goes down to 25 basis points?

Alan DOCHERTY: Yes, there are a couple of ways we can look at that. I mean at the moment, the effective cash rate is actually around 10 to 15 basis points, as you say. So we are really seeing the effect of that lower actual cash rate given the very unusual levels of excess liquidity in the system. So we are seeing that right now.

On the yield curve control out beyond three years, I think as you have rightly pointed out Brian, our replicating portfolio on our deposit hedge is on a five year tractor, and so we are sensitive to the movements in that five year yield. They are sitting at around 40 points at the moment, so you could do a pretty simple sensitivity on that, every 10 basis points is going to be over the five year period, around $70 billion on a $70 billion deposit hedge, but you would see that manifest over the course of the five year tractor rolling off, so a relatively modest effect in the year.

But yes, we will continue to look at how both, I mean, we label this cash rate headwinds, but obviously it is sensitive to swap rates as well, that reference to cash rates is simplifying a use of language. But we will continue to monitor what swap rates do, what the cash rate does, and I think it is helpful to provide that guidance around the impact, given the number of moving parts on our net interest margin over the next financial year.

Matt COMYN: Maybe the only thing I would add to both your question, BJ, and a little bit to Victor's, it is a combination of a much higher level of fixed rates and a reduction in TDs, actually our cash basis exposure has gone from $150 billion, another I think $25 billion down. So I think in the past we would basically see for every five basis points improvement in that cash bill spread, it is a one basis point group NIM, it is now out to six. So we have seen quite a material reduction in that, just given the shift in customer behaviour, particularly moving to fixed rates in home lending.

Melanie KIRK: Great, thank you Brian. We will take the next question from Matthew Wilson at Evans & Partners.

Matthew WILSON: Yeah, good morning. You can hear me okay? Hello?

Matt COMYN: Yes, we have got you Matt, can you hear us?

Matthew WILSON: Yep, all good, sorry. Two questions if I may. Firstly, what is the balance of capitalised interest income on the deferred loans?

Alan DOCHERTY: So in the period since deferral we have got some disclosure in our Annual Report in that regard, but for Retail loans we accrued $310 million of interest over the period of deferral. Obviously we have received payment on 25% of the Retail deferrals of that number. On Business lending we accrued interest of $150 million over the deferral period, and again, as we have disclosed, we received payment for 30% of the loans in deferral.

Matt COMYN: I think it is on about page 150 or so, isn't it, in the Annual Report?

Alan DOCHERTY: That is right.

Matthew WILSON: Alright, yes. And then secondly just with deferrals again, when I line up your disclosure on slide 13 with the letters that you've sent to the House of Representatives Standing Committee on Economics, they don't actually line up. And indeed if you use the letters, your bar chart would go up, not down. But more importantly, what is the percentage of deferrals that have an LVR greater than 70%, and given that 75% of your mortgage deferrals haven't made a payment, mortgage deferrals and business deferrals where you don't collect interest is very unusual practice. Do you think this is a policy error? Normally in these circumstances you would immigrate to interest only, which is what you've done in New Zealand.

Matt COMYN: Yes, so a couple of things Matt. I think the House of Reps, I think the latest update was June, I have to check. I am confident this disclosure is both more current, because we have gone out obviously into July. So it certainly should be the basis. But I am sure it will reconcile in that context.

I guess to your last point, look, deferrals, I think they have provided obviously significant support and flexibility for customers. Clearly the test is going to be how effectively we can make the orderly transition away from repayment deferrals. I think from our perspective making sure that we are maintaining regular contact with customers is clearly critical.

I mean, I think our experience, and certainly what I have seen internationally, that repayment frequency is particularly sensitive and unsecured, and so I think from a personal lending perspective it is a much shorter deferral period as an example. So that was a two-month, and we saw 95% of customers transition off that. I am probably less worried about, but I acknowledge it is a risk around people losing that repayment frequency, particularly in and around housing, and as I said the business lending book is 89% secured.

I think we have provided the disclosure obviously in terms of the proportion, I think the average dynamic LVR is 69%. And then there are variances across the geographical distribution, and so without rattling all of them off, you are consistent if you looked at the disclosure around where negative equity is, it skews to Western Australia. Western Australia would have the highest dynamic LVR, arguably you would say maybe that market has got less to fall. Interestingly I think Victoria has got the lowest dynamic LVR of the repayment deferrals, I believe it is 62%. New South Wales might be 64%. So I could not give you exactly the split that you are asking, because I think you wanted the percentage that were above 75. I do not have that number off the top of my head.

But it is an important variable that we watch closely, and it is a key variable in the context of where the risk is, that combination of income, how far ahead customers might be on their repayments in total, as well as where their dynamic LVR is.

Melanie KIRK: Great, thank you Matt. We will now take the next question from Andrew Triggs at JP Morgan.

Andrew TRIGGS: Thanks Mel. The first question just on deposits again and the NIM. Just keen to hear your thoughts on what you’re seeing in the deposit market. We’ve observed quite a significant improvement or reduction in term deposit rates, particularly late in the half and post-balance date. And just a follow up to Victor's question on that switching dynamic. Do you think this will continue at the current pace, or as TD rates and online savings rates seem to be compressing, perhaps the tailwind will start to lessen in future periods?

Matt COMYN: Yes, maybe I will start, and Alan, you add. I think it is a combination of things. I think as rates are coming down, there is probably just less sensitivity across different products in switching more broadly. We have certainly seen a reduction in our term deposit balances, we have seen rates coming down across the industry. That mix effect provides us a benefit clearly, and very strong growth in and around transaction and household deposits, which obviously is a key part of our strategy and oriented very much in terms of the way we want to serve our customers. And so we certainly want to continue investing in digital et cetera to help promoting that. But I think unfortunately from a customer perspective, the term deposit rates have come down to really reflect the lower interest rate environment that we are all operating within.

Alan DOCHERTY: Yes, I mean, I think the trend that you mentioned, the switching trend, is certainly a phenomenon that we have seen in other markets that have got lower for longer interest rates. So I think certainly we are seeing that. Now we obviously had a very unusual amount of deposit growth in this period. I mean, we went back and looked at whether there has been another period, certainly not in dollar terms, but even in proportionate terms, where we have seen that size of growth, 25% growth in transaction deposits, and even following the GFC we did not see growth of that shape and size.

So obviously that flow was very high in the last six months. We would not expect to continue at those levels, but we have had many years of double digit growth and transaction deposits. It is a very good grounds of competition for us given the digital assets that we have and the very high levels of digital engagement across our customer base which has been, I think, accelerated through the issues that we have seen over the past six months. So I think it is a trend that is here to stay. I think the volumes, we will see them moderate a little off the highs that we have seen over the past few months.

Andrew TRIGGS: Thanks. Can I just follow up on the cost side of the equation? Just the expectations for the profile and the run-off, or the reduction in spend on risk and compliance programs please, is that something that can be achieved, or partly achieved, in FY21?

Matt COMYN: Yes, I mean as we have just disclosed, I think we are at 72% of total investment spend. We expect that is going to come down in 2021. We are absolutely committed to continuing the investment and making sure that we are in a very strong position to manage financial and, of course, non-financial risk. We have made very good progress against the Remedial Action Plan that was set in place. But we do feel that we are in a position now to start increasing more of that investment towards productivity, growth and innovation, and that is certainly something we would like to deliver in the year ahead.

Alan DOCHERTY: As we have talked about before, there are multi-year programs of work that we are conducting which you see in that risk compliance and other programs item that still, I do not think we will be through all those programs of work during the course of the next financial year. So there will be an element of stickiness to that line item, certainly over the year ahead.

Melanie KIRK: Great, and we will have to be taking our final question now, and we will be taking it from Brendan Sproules from Citi.

Brendan SPROULES: Hi gents, good morning. I just had a question on the capital intensity of your business. Obviously slide 26 you show some deterioration, particularly in your non-Retail portfolios, but you have also seen some deterioration in your credit card portfolio. When are we going to start to see that emerge in the average risk weights? It does seem the average risk weights haven't really materially moved this period. You've obviously refined your estimate, but maybe you can give us some indication of the timing of when you expect to see those average risk weights moving higher?

Alan DOCHERTY: Yes, I mean we have obviously put the central scenario in there, which has got the expected increase in average risk weights, which we have got in the back of the slides. That is the updated estimates relative to those that we put out to the market in Q3. I am just trying to find that slide. So those risk weights, we think, will trend higher.

I mean one of the interesting things you have seen in the last half, and I called it out specifically, because it does hit a few of the line items within the Pillar 3 subcategories of our exposure, is through that granular allocation of collective provisions to stage three loans, which are nevertheless well secured, we hold CP against those rather than individually assessed provisions, and so that has allowed us to have a more accurate calculation of credit risk weighted assets across a number of Retail and non-Retail categories. So that has provided a degree of offset to the migration in average risk weights that you would otherwise have seen. But yes, we would expect some migration in risk weights, obviously in the next 12 months.

Brendan SPROULES: Just a question on funding, just on slide 116, is you've got another $21 billion of wholesale funding coming due in the next 12 months, could you tell us how much you've issued in the last six months, and I guess your expectations going forward for needing to actually renew that, given the strong growth in deposits that you have collected over the period and the build-up in liquid assets?

Alan DOCHERTY: Yes, we have done very little long term funding over the course of the past six months. We did draw down $1.5 billion on the RBA's term funding facility. I think prior to March, we did around $1.5 - $2 billion of new long term issuance, but really what you are seeing for the full year 2020 is mostly long term funding issuance that took place in the first six months of the financial year. And as you say, given that very strong growth in transaction deposits, I mean we would like to lend the funding that we have, obviously we are seeing that deployed, that additional funding in excess liquidity at the moment, and so, we would have a relatively low appetite for new long term debt issuance in the context of RBA's term funding facility and very strong levels of deposit growth.

Melanie KIRK: Great, thank you Brendan, that now brings us to the conclusion of the briefing. Thank you very much for joining us today. And if you have any follow-ups, please come back to us, thank you very much.

END OF TRANSCRIPT